Alpha Research & Management

Jan 2024 – ARAM AGG Plus Alpha Active Model Portfolios - Returns and Newsletter
AGG Plus Alpha – Systematic Active Fixed Income Model Portfolios to outperform the AGG

	Jan24 % Net Return	2024 YTD Net %	Trailing 1 year Net %	2023 YTD Net %	Cum Net Return since 1/2016	12mo Trailing Beta to AGG	12mo Trailing Correl to AGG
Baseline: (ModelPort20)	**+0.39%**	**+0.39%**	**+9.4%**	**+11.5%**	**33.1%**	**0.29**	**77%**
Aggressive: (ModelPort55)	**+0.37%**	**+0.37%**	**8.3%**	**11.3%**	**49.9%**	**0.43**	**84%**
Conservative: (ModelPort91)	**+0.93%**	**+0.93%**	**8.1%**	**10.3%**	**24.1%**	**0.22**	**47%**
AGG ETF	-0.15%	-0.15%	+2.1%	+5.7%	13.0%	1.0	100%

Bond markets had a volatile January 2024, selling off significantly during the month, with the 10- year UST ranging from 3.89% to 4.20%. Yields recovered in the last few days of the month, but the bond market benchmarks still ended the month with negative returns.

Our model portfolios all outperformed and had positive total returns for January, following on the heels of a very strong 2023, where we outperformed the AGG by approximately 5% across most of the model portfolios.

We customize portfolios using risk and liquidity parameters. We've selected 3 model portfolios to demonstrate the range of risk/return that is possible through Active FI Management.

We believe we have created one of the first, if not the first, Active Management strategies in Fixed Income that is scalable, by using ETFs, and creating a systematic process to rebalance portfolios in response to regime changes. We target the risk of the AGG, creating portfolios that are lower risk due to the Alpha created.

Our research piece titled ***'Are "Active" Fixed Income Funds Active?'*** was published last week. In this we created a framework to identify 'activeness' in fixed income funds through analysis of correlations and betas to the benchmark Agg Index – low correlation and volatile Betas are signs of an Active fund and strategy. The majority of Fixed Income funds that claim that they are active are not really so, and most end up being index huggers.

Our strategy allows Fixed Income to be viewed as a source of returns (and not insurance).

Model Portfolio Construction

Portfolios are constructed from a palette of over 400 Fixed Income ETFs. Unlike many "active" fund managers, we do not stray from US dollar bonds, and do not stretch for yield by using foreign bonds, preferred stock, options selling, or levered strategies.

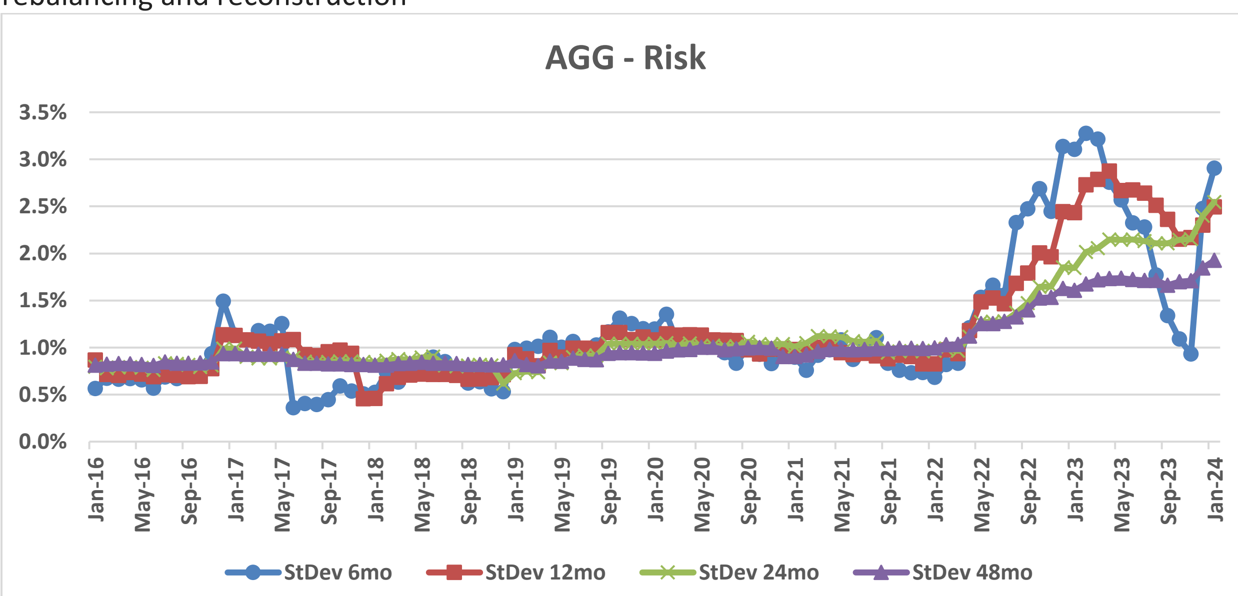
We first select parameters for sectors, liquidity, weights and diversification that determine which and how many ETFs are selected for the portfolio construction. Using the recent risk and volatility of the benchmark Agg index as the risk target, a risk target algorithm is then selected to systematically create the portfolio. A rebalancing process is selected to determine when to periodically reapply the systematic portfolio construction.

The combination of risk targeting and rebalancing makes the strategy Active, and the system automatically identifies and responds to regime and risk changes in the market environment.

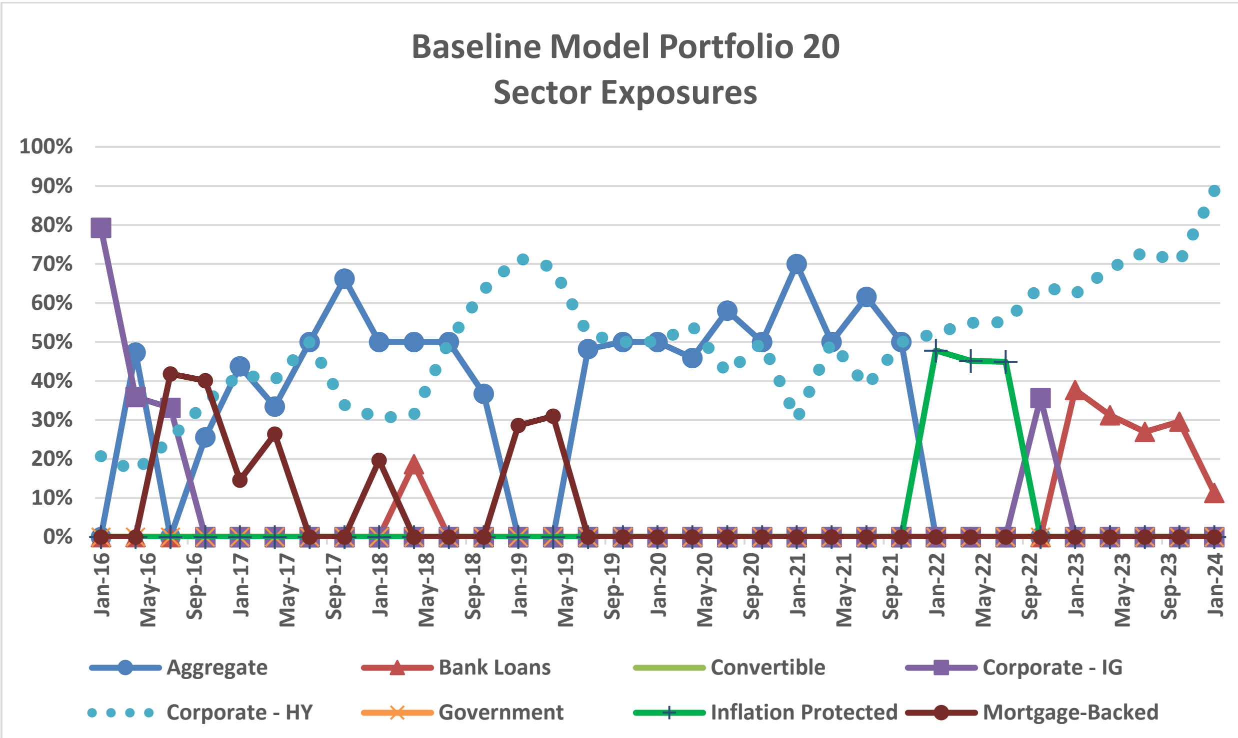
Model Name	Baseline ModelPort20	Aggressive ModelPort55	Conservative ModelPort91
Risk Target Algorithm	Dynamic Risk	Risk Scaling	Dynamic Beta
Liquidity	100mm+	100mm+	100mm+
Diversification	Concentrated	Concentrated	Concentrated
Sectors - Core AGG	Yes	Yes	Yes
Sectors - TIPs	Yes	Yes	No
Sectors - HY and Bank Loans	Yes	Yes	No
Sectors - Convertibles	No	No	No

Agg Risk is targeted to systematically construct portfolios

Changes in volatility, as well as returns (which capture rate changes), trigger portfolio rebalancing and reconstruction



Baseline Portfolio - Model Portfolio 20



Our Baseline model portfolio mimics the strategy of many managers by investing in sectors outside of the "Core Agg" construction of Investment Grade ("IG") bonds. We also allow TIPs, bank loans, and High Yield corporate bonds to be considered. We limit ourselves to US Dollar bond holding ETFs.

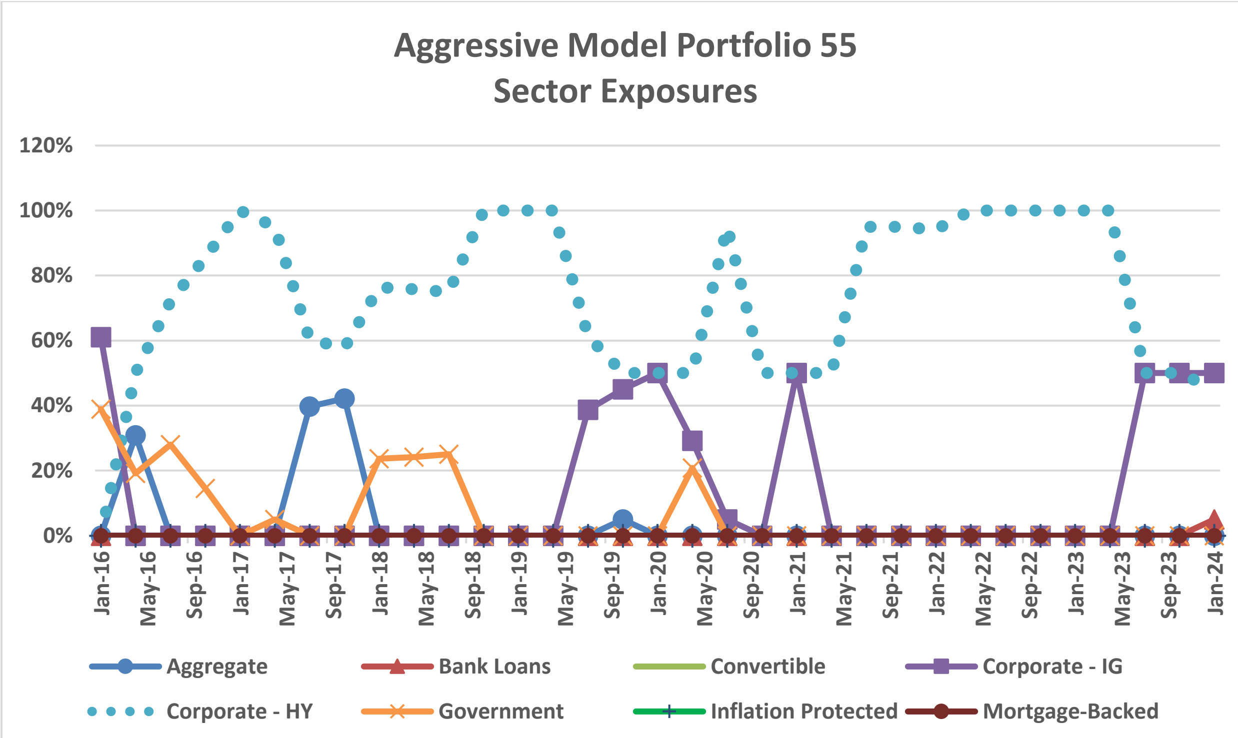
The Jan 2024 rebalancing shifted weights slightly between bank loans and corporate bonds (which turn out to be in short duration High Yield ETFs).

The system simultaneously responded to two primary factors starting in Fall 2022: the response to rising rates was to shorten duration; in order to match rising volatility and higher standard deviations, credit risk via HY and Bank Loans was embraced.

This model offers a significant improvement in both risk and return compared to the standard Agg financial products and funds where the majority of Fixed Income is invested.

The long term Beta to the Agg is only 0.6, with a 54% correlation, a result of the 2.9% annualized Alpha reducing relative risk.

Aggressive Portfolio - Model Portfolio 55



Our Aggressive model portfolio uses the same sectors as our Baseline portfolio (also allowing TIPs, bank loans, and high yield corporate bonds to be considered), but targets a higher volatility risk, to attempt to increase the long term Beta to 1.0.

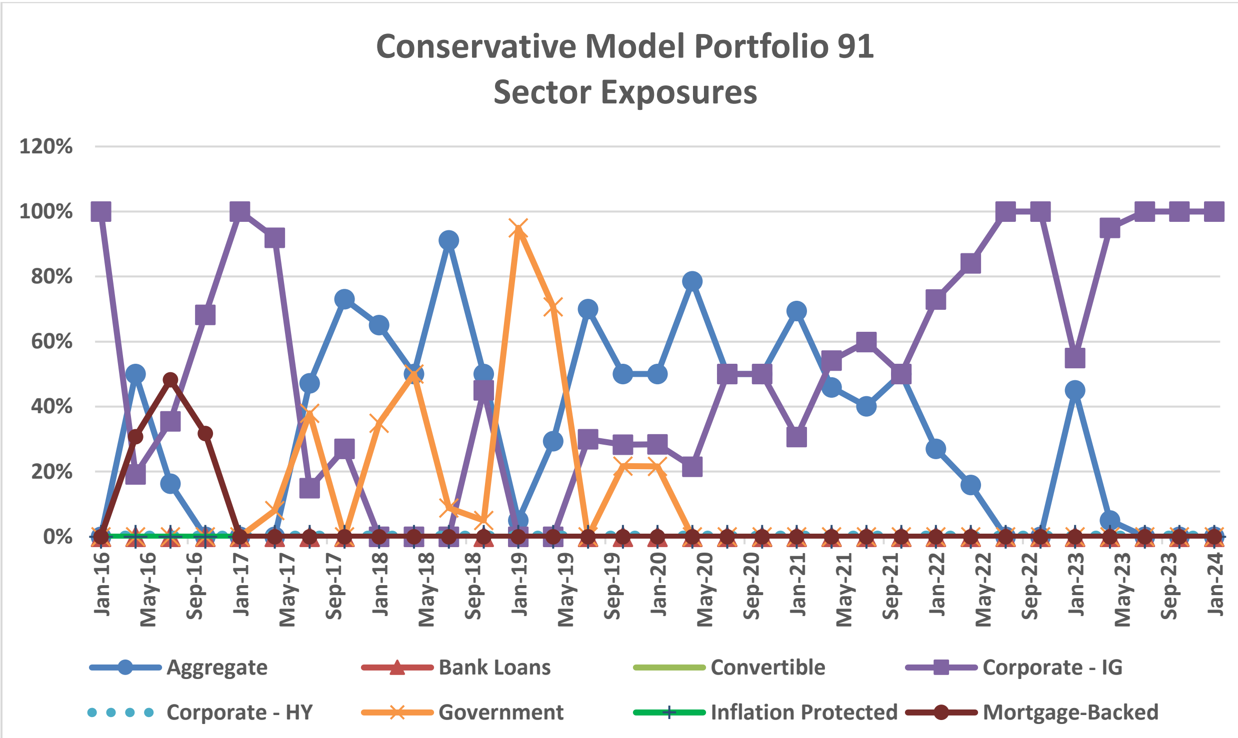
The resulting portfolios differ from the Baseline portfolio by occasionally using Govt and more IG corporate ETFs, primarily for higher duration.

The Jan 2024 rebalancing did not change the portfolio sectors significantly from the prior rebalancing.

This model should appeal to those who believe in an omnipresent Fed, who will bail out markets, allowing one to run higher risk in their portfolios.

The long-term Beta is 0.94, but with a correlation of only 59%, and Alpha of 4% annually.

<u>Conservative Portfolio - Model Portfolio 91</u>



Our Conservative model portfolio strictly uses IG bonds as defined by the Agg Index. The Risk algorithm is Dynamic Beta, which attempts to match a Beta risk of 1 every time the system rebalances.

The sectors have not changed for many months, being almost entirely in IG corporate ETFs. However, over time, there has been rotation into and out of Agg, Govt and MBS ETFs.

This model should appeal to those investors and managers who get their high yield exposure through other means, or do not want high yield exposure.

It is also proof that it is possible to generate Alpha in IG sectors through Active Management without resorting to high yield and non-dollar credit risk.

Of note is the outstanding 0.93% return for Jan 2024, versus negative returns for the Agg and market as a whole.

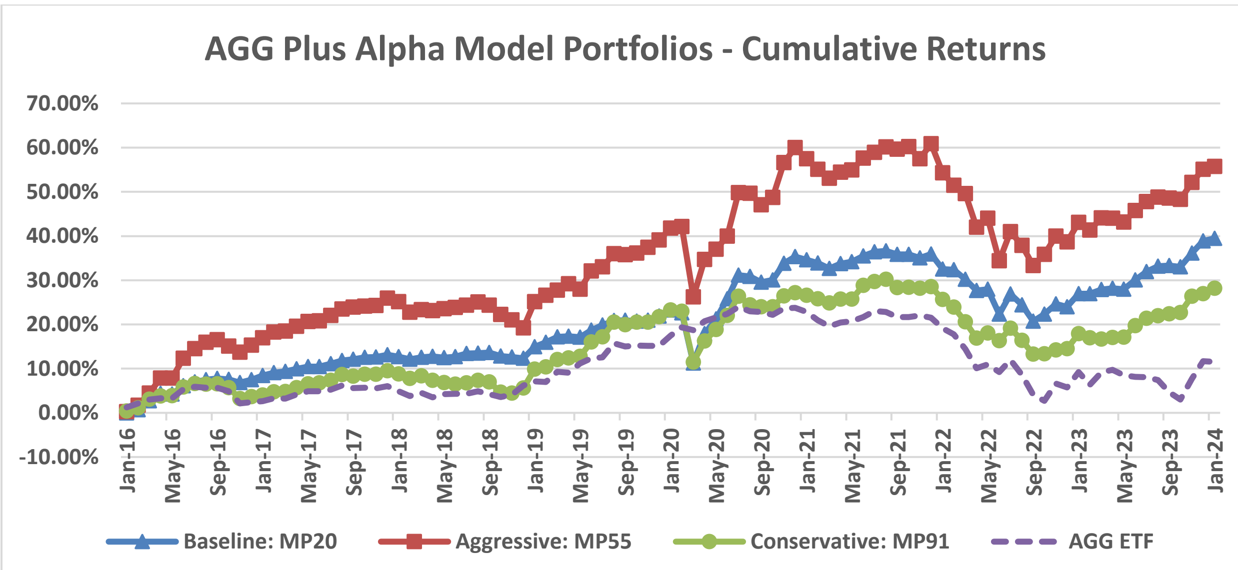
Also of note is the lack of recent MBS exposure. Most "Active" fund managers have been overweighting Agency MBS, especially after the MBS widening after Powell announced QT, and after bank blowups like SVB's. Our systematic construction suggests that this is not optimal.

Long-term Beta to the Agg is 0.7; correlation is 61%, and annual Alpha is 1.7%.

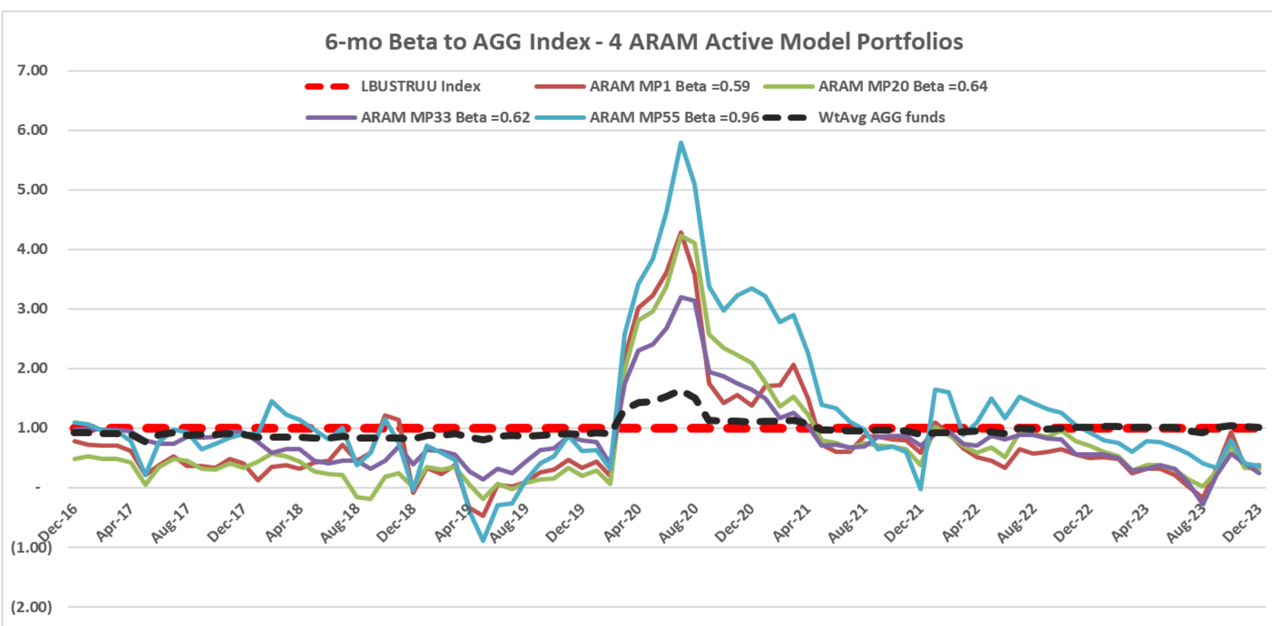
Cumulative Returns

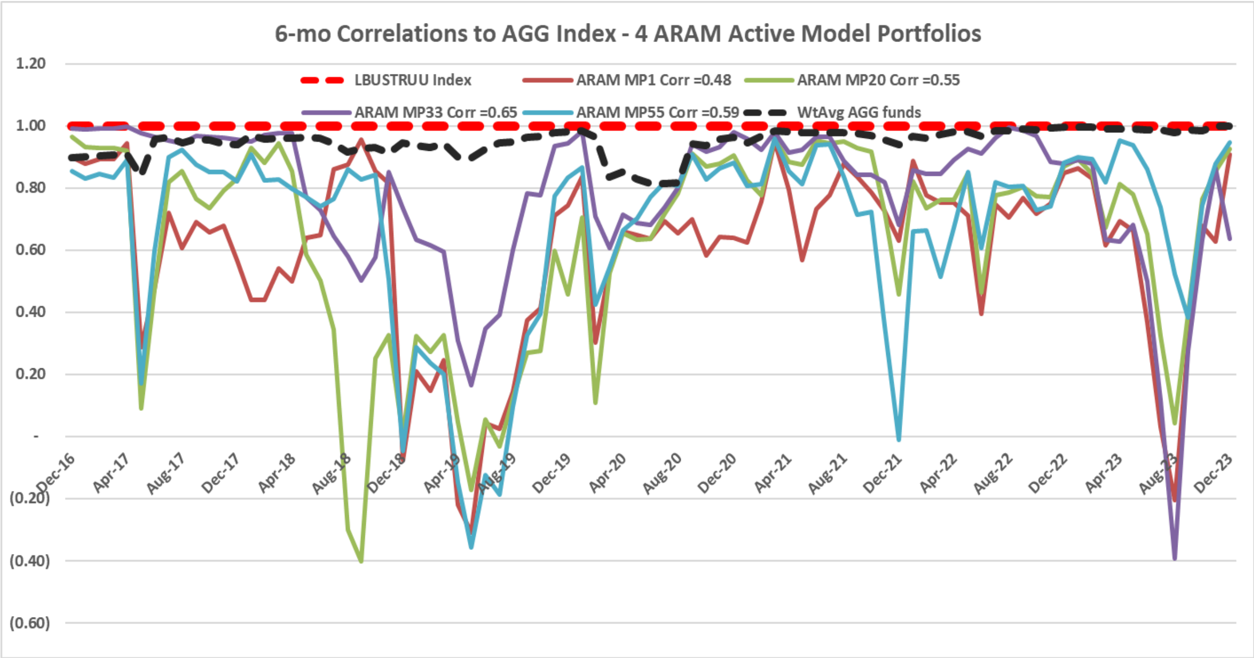
In spite of the very different portfolio construction of our 3 model portfolios, the portfolios generate consistent Alpha, with an increase in the number of months with positive returns (each 67%) compared to the Agg (53%). This creates positive skewness in returns (not shown), making this strategy and portfolios valuable for portfolio construction.

The dramatic response and difference in performance versus the Agg index since October 2022 demonstrates the uniqueness and value of our Active Systematic Rebalancing process.



The following charts demonstrate the “activeness” of our model portfolios vs Agg Funds.





Please call with questions.

Regards, Samir

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